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2015-2017

STATEMENT OF CORPORATE INTENT

KiwiRail

Cover photographs:
Brendon O'Hagon
Doug Cole Photography

This Statement of Corporate Intent has been submitted by the Board of KiwiRail Holdings Limited in accordance with Section 14 of the State-Owned Enterprises Act, 1986.
It sets out the Board's intentions and objectives to June 2017.

KiwiRail Overview

KiwiRail is a New Zealand Government-Owned Enterprise which owns and operates New Zealand's rail network and the between island ferry service. We are in the business of operating and optimising transportation and supply chain networks to enable New Zealands economic growth.

We conduct business in the following areas:

Logistics: We are a logistics provider to customers who use our rail freight and ferry services. Each week, approximately 900 freight trains operate on the KiwiRail network. They carry bulk freight such as coal and milk, containerised import or export freight to and from ports and full container loads for New Zealand freight forwarders. Three ferries provide the inter-island supply chain link with 4,600 sailings a year.

Shipping: We are an owner and operator of shipping services operating under the Interislander brand. Of our three ferries, two are owned and one is chartered.

Tourism Experiences: We provide tourism experiences by rail and sea. Three long-distance rail passenger trains - the Tranz Alpine, Coastal Pacific and Northern Explorer - provide daily, tri-weekly or seasonal services. Train charters provide specific rail experiences and service the cruise market. Interislander ferry services operate daily between Wellington and Picton return.

Public Transport: We operate public transport services in Wellington on behalf of Greater Wellington Regional Council. Each week, Tranz Metro suburban services provide approximately 2,200 services. KiwiRail currently operates the Capital Connection commuter train on weekdays between Palmerston North and Wellington. In Auckland, we control the movements of 2,000 passenger services a week on trains operated by Transdev on contract to Auckland Transport.

Infrastructure: We are an infrastructure provider in the form of the New Zealand rail network. Our role is to operate, maintain and improve the 4,000 km track network.

Rolling Stock: KiwiRail owns and operates 198 mainline locomotives, 4,585 freight wagons and approximately 60 passenger carriages. We are a rolling stock owner, maintainer and refurbisher. Mechanical services are provided at depots around the country as well as the major railway workshop in Lower Hutt.

Property: Our property group earns income from leasing-managing and developing the property portfolio.

1. Business Overview

The information in this Statement of Corporate Intent relates to years five to eight of a ten year plan to create a financially sustainable business.

The KiwiRail Turnaround Plan was endorsed by the Government in 2010. It set ambitious growth targets based on maintaining a connected supply chain network and achieving significant revenue growth, particularly in KiwiRail's Freight business unit.

Achieving that growth was to be achieved by investment in the network, in locomotives and rolling stock and in expanding capacity on Cook Strait.

Almost immediately, the plan suffered set-backs. It coincided with the Global Financial Crisis and was followed soon after by the Christchurch earthquakes and the Pike River disaster. A series of weather-related events and the rapid reduction in coal prices reduced freight volumes. More recently, problems with the ferry Aratere and the new DL locomotives impacted on revenue and costs during the latest financial year and the delivery of service for key customers.

Four years into the Plan, it is possible to draw two conclusions. Firstly, because there was no contingency in the original Turnaround Plan for unexpected events, it has become clear that KiwiRail will not be in a position to deliver a sustainable rail business as originally envisaged within the expected time-frame.

Secondly, it is apparent that the Plan's concentration of shareholding funding in the first four years, while kick-starting the business's recovery, will lead to a short-fall in funding in later years. In essence, Crown funding as envisaged in the Plan, will be insufficient to create a sustainable rail business by 2021.

There have been positives in the progress of KiwiRail in recent years as a result of government funding. The funding already allocated, despite setbacks, has improved the quality of our asset, increased rail's competitiveness and has generated an increase in freight revenue by 20% from 2010 to 2013.Rail has increased its share of the overall freight net tonne kilometres hauled by eight percent to sixteen percent with a modal shift from both road and coastal shipping.

The conclusion to be drawn is that investment in rail has resulted in benefits for the New Zealand economy. While the basic tenets of the Turnaround Plan remain valid, some of its assumptions need to be challenged.

As a result, KiwiRail has commenced a commercial review of the business with the aim of developing a new 30 year long term plan under the name "Project 2045".

Project 2045 is important because it provides us with an opportunity to re-examine the basic assumptions about rail's role in the New Zealand economy. The 2010 Plan took a step in this direction but remained largely consistent with the historical view of rail's role that are being challenged by changes in transportation technology and population patterns. Project 2045 provides an opportunity to consider a different operating model for a modern railway.

Rail continues to be important because of its complementary role to road transport in moving large quantities of containerised freight and commodity products that would otherwise need to be moved by road. For example, international trade – effectively imports and exports – accounts for a third of all freight movements. Rail carries significant proportions of this and other commodity traffic.

In conjunction with Treasury, the Ministry of Transport and the New Zealand Transport Agency, we are looking not only at operational commercial initiatives to improve performance and build scale, but also looking at whether it is prudent for the shareholder to invest to recognise the railway's public value benefits for the New Zealand economy.

Project 2045 is examining the economics of each route or service and providing a range of future options. Project 2045 is intended to provide the basis for a long-term strategy to build long term certainty for the business. The goal is to understand the business in a more comprehensive way so that we can adjust the plan to make it capable of achieving the objective of a sustainable rail business.

We expect significant progress to have been made in identifying options by the middle of FY2015.

What is becoming increasingly evident is the importance of the "Golden Triangle" of the Auckland – Tauranga route driven by the current and future expected growth of the Auckland metropolitan areas, Auckland Port and the recent announcement regarding Fonterra, Kotahi, Port of Tauranga and the development of Hamilton Intermodal hubs.

Issues related to this growth that are fundamental to the development of KiwiRail's business are the increasing road traffic congestion within the region and the transition to much larger ships calling at the major ports.

In addition to Project 2045, we have implemented a "Back to Basics" performance framework as part of our drive to optimise the business and develop a cost effective and efficient entity. The modern KiwiRail will be ready for investment growth and active in engaging our customers and employees in the future direction of the business. The framework focuses on four perspectives of the business: Sustaining a Zero Harm environment, Engaging our customers, Empowering our people and Delivering operational performance to improve our financial position.

Our approach will be accompanied by a unified "total KiwiRail" operating model which will enable our strategy of building a less complex and cost efficient end to end enterprise with aligned values, profit performance metrics and accountability. We will invest in our leadership capability and performance reporting to deliver the new operating structure.

The immediate aim is to focus on the sectors and customers that will enable our growth objectives, improve our operating cost position, restore market and shareholder confidence, and improve our safety performance.

2. Nature and Scope of the Business

KiwiRail is in the business of owning and optimising transportation and supply chain networks to enable New Zealand's economic growth. We:

- Own and operate a national rail network which meets the needs of our customers.
- Provide for the transport of bulk and consolidated freight.
- Provide ferry services (forming the 'bridge' between the North and South Islands) for rail and road freight and for passengers and their vehicles.
- Provide and support rail passenger services in metropolitan areas and long distance services for both domestic and tourist markets.
- Manage and develop property holdings for rail operations and appropriate third party land use.

3. Business Outlook and Strategy

The primary goal for FY 2015 is to improve the financial, safety performance and restore customer and shareholder confidence after a period during which incidents and issues have impacted on earnings and on the overall public perception of KiwiRail.

The secondary goal is to begin implementing the insights from Project 2045 so that we can begin creating an operating model that fits with our future business strategy.

FY 2014 had begun promisingly. Freight revenues in the lead up to Christmas 2013 were ahead of targets but two separate issues combined to detract significantly from the final financial result:

1. In November 2013 our ferry Aratere lost a propeller during a Cook Strait sailing, taking it out of service and necessitating a trip to Singapore for repairs. The costs associated with repairs, lost freight and ferry business and charter of a replacement vessel amounted to approximately $27 million.

2. In early 2014, the asbestos contamination in the new Chinese-built DL Freight locomotives resulted in the locomotives being withdrawn for remediation. The loss of 24 locomotives from a fleet of 190 put further strain on the freight business which was already feeling the impact of the Aratere's absence for repairs.

In the early months of FY 2014, the Freight business was on a growth path that would have taken it past its revenue and EBITDA targets for the financial year. The impact of the above two issues, and the deterioration in the export logging and dairy market during April to June 2014, was sufficient to slow the growth in Freight revenue that had been achieved over the early years of the Turnaround Plan.

On-time performance improvements for premium freight services, which had been benefiting from investment in the network and rolling-stock, declined due to the ship and locomotive issues.

We approach FY2015 with confidence that the two issues that weighed so heavily on FY2014 performance are behind us. However we remain cautious as the New Zealand economy is solid in some sectors and patchy in the core commodity sectors that represent 41% of our revenue (Dairy, Coal, and Forestry). Annual growth for the next three years is forecast to be in the region of 2.5 percent to 3.5 percent; although this depends on the outcomes of the Project 2045 exercise.

Sustaining a Zero Harm Environment

KiwiRail regards Zero Harm as a licence to operate. Chief Executive Peter Reidy has made Zero Harm a core priority and indicated its importance by appointing a dedicated general manager to the Executive Leadership Team.

Zero Harm at KiwiRail is about caring for and protecting each other, our business, our community and our environment.

Safety performance within the business is measured by the Lost Time Injury Frequency Rate (LTIFR) and the Total Recordable Injury Frequency Rate (TRIFR). These lagging indicators are supported by leading indicators such as safety conversation frequency and personal safety action plans.

Total harm injuries have reduced by 45 percent year on year. TRIFR was down from 53.0 in FY 2013 to 29.3 in FY 2014 while LTIFR showed a slight reduction from 13.0 in FY 2013 to 12.8 in FY 2014.

Our goal for LTIFR in FY2015 is 6.4 and 20.5 for TRIFR reflecting targeted reductions of 50% and 30% respectively.

Our lost time and total recorded injury rates place us among the less well performing businesses when compared with leading businesses in Australia.

The business is implementing a five-point Zero Harm strategy that involves identifying and reducing critical risks, implementing compliant management systems, building Zero Harm capability, active engaged leadership and environment accountability.

Particular areas of critical risk identified have been safety in tunnels, signals passed at danger and track occupancies. As the network becomes busier, the opportunities for track maintenance by work gangs and contractors become short making safe occupancy even more critical.

KiwiRail will make a material improvement to our safety performance through active leadership, workforce engagement and national consistent operating discipline.

Engaging our customers

Considerable progress has been made over the past four years in improving relationships with customers. In Freight, strengthened partnerships with major customers such as Fonterra and the key freight forwarders have resulted in increased freight traffic.

The willingness of a number of freight forwarders to establish depots on rail land in main centres is an indication that we have moved beyond being competitors to being business partners.

One of the most important elements of “the value proposition” that our customers seek from us is on-time performance.

Improvements in on-time performance, particularly in premium freight trains arriving at destination within 30 minutes, have been slowed in FY 2014 by the issues affecting Aratere and the DL locomotives. Reduced derailments and speed restrictions are helping to consolidate the longer-term gains we are making. We expect these gains to continue in FY 2015.

The percentage of Interislander sailings arriving within 15 minutes of schedule had been improving (90% prior to the Aratere incident) but the Aratere’s absence disrupted this pattern in FY2014. With Aratere back in service for the 2015 year, we are forecasting on-time performance to reach 90%.

Wellington’s Tranz Metro, benefitting from improved infrastructure, new electric units and a focussed management approach, achieved 94% of trains arriving at destination within five minutes. We expect this improvement to be sustained. In addition, Scenic Journeys has grown customer satisfaction with introducing new rolling stock and improved customer experience.

Empowering our people

We recognise that to deliver on our targets, we must have an engaged and motivated workforce led by leaders with focus, discipline and urgency to deliver results.

We have developed six values we regard as critical to achieving engagement and motivation.

1. **Care and Protect** is our most important value with recognition across the business that everyone is a safety leader who must make it personal and set high standards.

2. **One Winning Team** is an expression of the “one enterprise” concept which empowers the workforce to make decisions, value diversity and collaborate to achieve results.

3. **Great Customer Experiences** refers to the fundamental need to be commercial, engage with our customers, understand their needs, deliver the right product and right service.

4. **Strive for Excellence** represents the desire to hunt for improvement opportunities, actively challenge the status quo and seize the initiative.

5. **Deliver Results** is a business fundamental that requires us to hold each other accountable and act with focus, discipline and urgency.

6. **Straight and True** requires us to be honest and up-front, treat people with respect and follow through.

Our most visible performance indicator is the staff engagement index which is indicating that our staff have become more engaged. Our participation rate has increased by 7% points from 74% in FY2013 to 81% in FY2014. From an engagement index of 65 in FY2010 and 67 in FY2012, we have moved to 73 in FY2013 and 74 in FY2014. We are targeting an index of 77 in FY2015.

We accept that the difficult 2014 financial year may have a short-term impact on the way our staff regard KiwiRail. However, we are confident the drive to build one enterprise and embed the values we have identified will improve engagement. This result will be supported by the introduction of leadership development programmes across the organisation, which along with our Back to Basics framework, will preview clarity to our people on our direction/ focus which will further improve engagement levels over time.

Delivering operational performance

Delivering results as one company still requires the business units to perform strongly. Freight’s role in earning roughly two thirds of KiwiRail’s revenue makes it the “engine-room” of financial performance.

In FY 2014, the ferry and locomotive issues we have described interrupted what had been satisfying growth in rail freight revenue and EBITDA. With these issues now behind us, we are forecasting that freight revenue will grow 7% to $469m and EBITDA of $171.5m (12% growth).

A growing economy, the increasing momentum of the Christchurch re-build, growth in revenue from export-led business and a focus on driving cost efficiency and train utilisation will support growth for KiwiRail. The bulk products business has been affected in the past two years by the issues facing Solid Energy and drought that has reduced seasonal milk flows. The decline of coal volumes is expected to continue which will impact bulk revenue.

Fonterra’s policy of moving towards fewer and larger processing facilities, and streamlining its logistics arrangements, should assist our freight growth. Fonterra is a supporter of the move to fewer and larger ships, which over time could also benefit KiwiRail.

Our forestry business has performed strongly in recent years, however, international wood prices have weakened over the last 2 to 3 months, casting some doubt on the extent to which we can expect continuing growth in this sector during the next 12 months.

The domestic market has benefited from the quality of the relationship we have developed with freight forwarding customers and their decisions to establish depots at our freight terminals. The loss of capacity on Cook Strait during FY2014 affected domestic business. Restoring it will depend on rebuilding both capacity and service reliability.

Interislander business will take time to recover from the issues that took Aratere out of service for seven months. This is reflected in our revenue forecast FY 2015 ($163 million) and EBITDA ($23.9 million).

Aratere resumed service soon after the beginning of the FY2015 but business lost – both freight and passenger - while the ship was out of service, may take up to two years to recover completely.

Independently of the *Aratere* issue, KiwiRail has been working on longer term plans for its ferry business. With the rail-capable ferry *Arahura* due for replacement by 2016, consideration has been given to options for meeting future freight and passenger demand without the need to acquire a replacement rail-capable ship.

Passenger services in the form of long-distance Scenic Journeys and urban transport provider Tranz Metro contribute slightly less than five percent of KiwiRail EBITDA. Between them, they are forecast to contribute $4.2 million to EBITDA in FY2015, with the total amount expected to come from Tranz Metro and for Scenic Journeys to breakeven.

KiwiRail operates the Tranz Metro service under contract to Greater Wellington Regional Council (GWRC). This contract expires in June 2016 and has delivered sustainable customer service, reliability and punctuality improvements that have supported increased customer satisfaction and patronage for the region. KiwiRail is still considering the decision to renew the GWRC contract and whether to compete for the contract to operate the Auckland Metropolitan network when it is tendered in the same period.

The long-distance passenger business has begun to recover from the impact of the Christchurch earthquakes on the tourism industry. We are forecasting the business to break even FY2015 after a loss of $1.2 million FY2014.

Contracts to maintain urban passenger rolling stock has been a valuable contributor to revenue in the past. The Electric (EMU) units will now be maintained by CAF (Auckland Transport's Rolling Stock provider). The loss of the contract for the Auckland network will reduce forecast revenue FY2015 by more than $2 million or $3.8 million.

Infrastructure & Engineering (I&E) is not a revenue generator but through its role in maintaining and developing the railway network, it is a vital element in the business. The investment in the network over the past 10 years and in new rolling stock over the past four years has begun to address the previous 15 to 20 years of underinvestment.

Track infrastructure improvements have seen a reduction in temporary speed restrictions and derailments. These factors have contributed significantly to the modal shift gains that have been made in the Freight business.

Over the past two years we have sought to achieve productivity gains within I&E. This has occurred in the form of the sale of Hillside workshops in Dunedin and some reductions in staff numbers. During the period FY15-FY17, we will bring considerable focus and discipline to identifying and capturing efficiencies and productivity improvement cost savings within the I&E business without compromising the focus on prudent management of the network through network renewals (new rail, sleepers, bridge replacement, line destressing etc) where $173 million will be spent in FY2015.

Money spent on infrastructure upgrades will be concentrated on lines and areas that are most heavily used. FY2015 $31 million will be spent on infrastructure upgrades, in particular on the Golden Triangle (Auckland-Tauranga), the southern South Island dairy route and improvements to yards and terminals.

Improving our financial position

KiwiRail has taken a cautious approach to its forecasts for FY2015, expecting group revenue of $760.9 million compared with last year's SCI plan for the year of $797.7 million. Our EBITDA forecast of $110.1 million aligns with the figures submitted to our shareholder in support of the $198 million equity funding approved in the Budget 2014. Both represent improvement on FY2014 results.

Plans are based on continued growth in Freight, regaining market share in the ferry business, improving our operating cost base through asset and labour productivity, and optimising cost efficiency. We have made progress with the establishment of a property business unit which will be identifying opportunities for further enhancing revenue.

As an improving network has a positive effect on on-time performance and customer service, there are greater opportunities to improve freight margins and the profitability of services.

4. Our Core Priorities for the next 12 Months

1. Improve our safety performance
2. Build leadership capability and key talent
3. Simplify the operating delivery structure
4. Improve consistent on time performance
5. Reduce the cost of operations
6. Improve rolling stock asset utilisation and up time
7. Build and embed asset management competency and maintenance capability
8. Optimise Cook Straight ferry asset base
9. Partner with key industry stakeholders
10. Build sales and commercial management capability

5. Business Objectives & Performance Targets

TABLE 5.1

	2013 Actual	2014 Actual	SCI Horizon 2015 Plan	2016 Plan	2017 Plan
Sustaining Zero Harm Environment					
(a) LTIFR	13.0	12.8	6.4	4.5	3.2
(b) TRIFR	53.0	29.3	20.5	14.0	10.0
(c) GHG emissions per NTK (gms)					
- KiwiRail	32.5	31.1	30.4	30.1	30.1
- HGV (UK)	123.4	123.2	#N/A	#N/A	#N/A
(d) Abatement, infringement and enforcement notices under the Resource Management Act	0	0	0	0	0
Improving our Financial Position					
(e) Operating revenue	727.0	723.6	772.4	774.9	804.7
(f) Grant income	181.7	93.4	48.2	34.5	50.9
(g) Operating surplus before major one-off items	108.2	75.3	110.1	124.1	137.9
(h) Net operating surplus	108.2	77.5	110.1	124.1	137.9
(i) Operating Margin	15%	11%	14%	16%	17%
(j) Revenue per employee ($000)	183	180	192	193	201
(k) NPAT	(174.7)	(248.0)	(137.4)	(134.3)	(136.7)
(l) Network Capital Expenditure	196.1	182.2	204.5	199.5	233.7
(m) Major Metro Project Capital Expenditure	149.0	67.0	11.0	-	-
(n) Other Capital Expenditure	140.9	105.4	111.6	110.9	104.2
(o) Rail Freight NTK (m)	4,692	4,530	4,781	5,134	5,203
(p) Rail Freight average yield (c/NTK)	8.20	8.30	8.61	8.47	8.74
(q) Interislander Commercial Vehicle lane metres (000s)	1,209	1,244	1,231	1,265	1,299
Engaging our Customers					
(r) Ontime Performance					
- Freight premium services	89%	84%	89%	94%	94%
- Interislander	85%	72%	85%	92%	93%
- Metro	94%	94%	95%	95%	95%
- Scenic	81%	67%	75%	75%	75%
(s) Customer Satisfaction - Interislander	76%	75%	77%	79%	80%
(t) Customer Satisfaction - Scenic Journeys	93%	91%	93%	93%	93%
(u) Customer Satisfaction - Tranz Metro	92%	92%	93%	93%	93%
Delivering Portfolio Performance					
(v) Premier Train Utilisation	65%	63%	65%	67%	69%
(w) Locomotive MDBF (000 km)	46	45	50	55	55
(x) Group labour costs as % of Revenue	40%	42%	39.3%	38.7%	38.3%
(y) Freight fuel and traction electricity as a % of Revenue	16%	17%	13%	14%	13%
(z) Interislander fuel costs as a % of Revenue	21%	20%	20%	19%	21%
(aa) Total operating costs per employee ($000)	155	162	165	161	161

			SCI Horizon		
	2013 Actual	2014 Actual	2015 Plan	2016 Plan	2017 Plan
Empowering our People					
(ab) Staff Engagement	73%	73%	76%	78%	80%
Key Investment Outcomes					
(ac) Rolling stock replacements					
- Wagons (no. of new units)	360	-	150	150	150
- Locomotives (no. of new units)	20	8	-	-	-
(ad) Network Renewals					
- New Sleepers Laid (000)	96	67	104	104	110
- New Rail Laid (km)	25	24	17	17	20
- Lines Destressed (km)	192	130	157	180	200
- Span Metres Replaced	446	130	490	446	262
- Timber Piers Replaced	65	25	55	50	50
- Culverts Replaced	24	20	26	32	32
- Level Crossing Upgrades	8	5	10	10	10

Reference	Description of Performance Measure
(a) (b)	KiwiRail takes health and safety performance extremely seriously. We operate a heavy engineering transport operation that presents many risks for accident and injury. We will continue to drive the safety message and improve our workplace safety record so our staff return home as they came to work. KiwiRail has signed up to a Zero Harm programme, with significant improvements to safety targets expected over the next three years. Our key measures of safety outcomes are Lost Time Injury Frequency Rate (LTIFR) and Total Recordable Injury Frequency Rate (TRIFR). LTIFR measures the number of injuries that result in an inability to work as a frequency rate per million hours worked. TRIFR measures the total number of injuries recorded as a frequency rate per million hours worked.
(c) (d)	As part of its corporate responsibility commitment we plan to reduce our carbon footprint by reducing greenhouse gas emissions. For comparison purposes, we have shown the equivalent greenhouse gas emissions for Heavy Goods Vehicles (HGV) in the UK as published by the Department for Environment, Food & Rural Affairs (note that only historic actuals are available for this). A zero target for notices received under the Resource Management Act highlights the importance we place on complying with environmental law in our activities.
(e) (o) (p) (q)	Driving revenue is critical to the success of this business plan. Growth in the Freight division is especially critical, as is recovery of passenger revenue in the Interislander business after the impacts of the outage of the Aratere in 2014.
(f)	KiwiRail receives operating grants from the Crown to fund major metro projects and other public benefit capital items. This funding has been reducing since 2013 as the major metro projects are completed.
(g) (h) (i) (k)	Net operating surplus growth is a critical element of the funding required to deliver the investment programme we have planned. In 2015 it is important build momentum after the impacts on profitability during 2014.
(l) (m) (n) (ac) (ad)	The capital plan has been separated between expenditure for the network infrastructure (including partially funded Metro renewals) and expenditure in our other business units (Freight, Interislander, Passenger, Property and Corporate). We have outlined a number of expected deliverables for the rolling stock and network renewals expenditure.
(r)	On time performance across all our services is a critical measure to ensure we are meeting our customer expectations. This measure is based on arrival within time tolerances of: Freight 30mins, Metro 5mins, Scenic 15mins and Interislander 15mins. Premium trains performance in 2014 was impacted by both the Aratere outage and DL locomotives being out of service. Interislander's performance in 2014 was impact by both the Aratere outage and a number of weather events. Both businesses a targeting a return to higher levels in 2015.
(s) (t) (u)	We regularly monitor satisfaction of our fare paying customers. Despite the disruptions of the Aratere outrage, customer satisfaction remained strong and we are targeting higher levels over the next 3 years. High levels of satisfaction continue to be achieved is the Scenic and Metro businesses. The introduction of the Matangi fleet has assisted with attainment of the high customer satisfaction in the Metro business.
(v)	Capacity Utilisation of our Freight Trains is an important measure underlying our profit growth. Increasing the volume carried on our existing train plan rather than increasing the number of services will improve this measure.
(w)	The reliability of our locomotive fleet is measured by the distance travelled between mechanical failures expressed as the Mean Distance Between Failure (MDBF). 2014 was impacted by the outage of the DL locomotives. We have achieved higher levels for a number of months in the past and a confident we can improve the overall performance on a consistent basis.
(x) (y) (z) (aa)	Driving continued productivity and cost efficiency improvements throughout our business is a fundamental to the success of the business.
(ab)	Every year KiwiRail completes a staff engagement survey. Given the importance of an engaged workforce to deliver our plan, a strong engagement result is required. We have established our new values and will be communicating these across the business in first quarter of FY2015. This, along with a range of other initiatives, will support increasing levels of engagement.

BUSINESS UNIT FORECASTS

The following table outlines the key financial outcomes for our business units.

Table 5.2

			SCI Horizon		
	2013 Actual	2014 Actual	2015 Plan	2016 Plan	2017 Plan
BUSINESS UNIT SUMMARY ($m)					
(a) Operating Revenue					
Rail Business					
Freight	432.5	433.3	469.4	492.5	512.8
Infrastructure and Engineering	39.0	37.7	43.3	44.3	45.4
Corporate, Property and Support Services	37.0	39.1	43.3	48.2	44.8
	508.5	**510.1**	**556.0**	**585.0**	**602.9**
Interislander	159.6	150.0	162.9	167.8	175.0
Scenic	20.2	21.2	22.3	22.9	23.6
Tranz Metro	50.4	52.8	55.8	56.5	58.0
Metro Maintenance	42.0	42.6	31.9	-	-
Inter BU Eliminations	(53.7)	(53.1)	(56.4)	(57.4)	(55.0)
	727.0	**723.6**	**772.4**	**774.9**	**804.7**
(b) Net Operating Surplus before major one-off items					
Rail Business					
Freight	151.2	150.1	172.2	184.5	184.5
Infrastructure and Engineering	(41.1)	(52.8)	(57.0)	(58.4)	(58.4)
Corporate, Property and Support Services	(34.4)	(43.4)	(36.6)	(32.5)	(18.7)
	75.7	**53.9**	**78.5**	**93.7**	**107.4**
Interislander	24.3	11.4	23.8	25.8	25.8
Scenic	(1.5)	(0.9)	0.0	0.2	0.2
Tranz Metro	4.6	5.0	4.2	4.5	4.5
Metro Maintenance	5.0	5.9	3.6	-	-
	108.1	**75.3**	**110.1**	**124.1**	**137.9**
(c) Capital Expenditure					
Rail Business					
Freight	104.9	66.9	66.2	63.8	71.4
Infrastructure and Engineering	196.1	182.2	204.5	199.5	233.7
Corporate, Property and Support Services	27.0	29.8	34.6	28.5	22.7
	328.0	**278.9**	**305.3**	**291.8**	**327.8**
Interislander	4.5	8.0	9.5	17.0	8.6
Scenic	4.5	0.7	1.3	1.6	1.5
Tranz Metro	-	-	-	-	-
Metro Maintenance	-	-	-	-	-
	337.0	**287.6**	**316.1**	**310.3**	**337.9**

6. Shareholder Equity Funding

In May 2010 the Government announced its support for KiwiRail's transformation with a $750 million equity investment. In May 2013 a further $94m was approved for KiwiRail's FY2014 year and in May 2014 $198m equity funding was approved for FY2015 in line with our budget submission request.

Funding Assumptions for 2016 and 2017

The financial forecasts and performance measures included in Tables 6.1 and 6.2 are based on a number of important funding and capital structure assumptions.

The plan to turnaround KiwiRail's financial performance assumed the Crown invests approximately $1.1 billion to support the 10-year $3.1 billion (excluding Metro projects and renewals) capital programme. The Government has now appropriated $1,042 million of equity funding, including $198 million in the Crown's 2014 Budget.

The $198 million appropriation for FY2015 included recognition of a number of risk and commercial factors. These include:

- Remediation work for buildings due to seismic assessment.
- Higher than previously expected capital expenditure associated with long tunnels.
- KiwiRail's belief that the pricing for the transport of Solid Energy's coal from the West Coast does not fairly reflect the costs of operating the services and the associated infrastructure. The matter is in dispute and is the subject of ongoing discussions between the parties.

Under the current business forecasts additional funding will be required for FY2016 and FY2017. Project 2045 will give us greater clarity of the levels of funding required with possible options to reduce that and we continue to discuss our future funding requirements in accordance with the regular Crown economic and fiscal forecasting cycles. Our assumption is that the Crown will continue to support KiwiRail's funding needs with equity and we have prepared this Statement on that basis. It is important to note, however, that the Government has made no commitment to any un-appropriated funding at the time this Statement was prepared. We will continue to drive productivity and efficiency performance improvement and use the outcomes of Project 2045 to explore ways of minimising the support required from the Crown.

7. SOE Performance Measures

Table 7.1

	2013 Actual	2014 Actual	SCI Horizon 2015 Plan	2016 Plan	2017 Plan
Shareholder Return Measures					
Total Shareholder Return	n/a	n/a	n/a	n/a	n/a
Dividend Yield	Nil	Nil	Nil	Nil	Nil
Dividend Payout	Nil	Nil	Nil	Nil	Nil
Return on Average Equity	-35.7%	-46.9%	-29.2%	-26.9%	-25.7%
Profitability/Efficiency Measures					
Return on Average Capital Employed	-16.6%	-33.5%	-19.1%	-16.6%	-14.2%
Operating Margin	14.9%	10.7%	14.3%	16.0%	17.1%
Leverage/Solvency Measures					
Shareholder's Funds to Total Assets	58.2%	51.3%	55.4%	58.5%	58.0%
Gearing Ratio (net)	27.1%	44.5%	45.3%	41.9%	40.4%
Interest Cover	7.1	5.6	7.0	8.0	9.3
Solvency (current assets/current liabilities)	1.30	0.91	1.27	1.33	1.35

Note that to provide meaningful comparatives the above ratios assume that additional funding required will be received as equity.

8. Commercial Value of the Crown's Investment

The Board has used the method of discounted cash flows (DCF) to estimate the value of the KiwiRail Group as at 30 June 2014.

There has been a reduction in the commercial value related to operating free cash flows of $647 million. This reflects the reduction in operating surplus projections as a result of significant impacts on the FY2014 result and their impact on following years.

Based on the current earnings projections, it is not expected that the Group will be tax paying in the projected earnings period. The present value of tax payable on ungeared earnings is, therefore, zero.

Net Debt increased by $59 million compared to 30 June 2013. This reflects a reduction in cash balances of $49 million and additional asset finance as part of our major plant funding programme.

There has been a decrease in discount rate of 0.3%. The impact of this is an increase in value of $15 million.

$m	30 June 2013	30 June 2014
Present Value of Pre-Tax Free Cash Flows	(427)	(1,088)
Less Present Value of Tax Payable on Ungeared Earnings	0	0
DCF Enterprise Value	**(427)**	**(1,088)**
Less Net Debt	(147)	(206)
DCF Equity Value	**(574)**	**(1,294)**

The key points about the manner in which this valuation was derived are as follows:

- The DCF methodology used to calculate the Net Present Value (NPV) of the entire KiwiRail Group includes all subsidiaries on an after tax basis.
- The DCF / NPV was based on the nominal (ie inflation-adjusted) future cash flows set out in KiwiRail's two year operating plan, with forward projections made through years 3 to 20 consistent with the current business plan. It is important to note that these projections will change at the completion of Project 2045.
- A terminal value of zero has been assessed.
- A discount rate of 9.5% has been used (as compared to 9.8% for the 2013 valuation).
- PwC has confirmed the mathematical accuracy of the calculation of the DCF valuation prior to approval of the DCF value by the Board

9. Accounting Policies

The Company's detailed accounting policies are set out in Appendix One: Statement of Current Accounting Policies.

10. Dividend Policy

The Strategic Plan requires significant investment over a 10-year period. A significant amount of that investment is from the Shareholder. As such KiwiRail does not expect to make any dividend payments over the period of this Statement.

11. Reporting to Shareholding Ministers

KiwiRail will provide to Shareholding Ministers:

- An Annual Report and Half Yearly Report in accordance with sections 15 and 16 of the State-Owned Enterprises Act 1986. These will include a statement of financial performance, a statement of financial position, a statement of cash flows and such details as are necessary to permit an informed assessment of the Company's performance
- Continuous Disclosure reporting as required by the Crown Ownership Monitoring Unit (COMU)
- Regular reporting to COMU for performance monitoring during the Strategic Plan investment period
- Other information requested by Ministers in accordance with section 18 of the State-Owned Enterprises Act 1986.

12. Procedures for Share Acquisitions

Purchase of shares in any company or interests in any other organisation will be subject to prior agreement with Ministers in accordance with the New Zealand Railways Corporation Act 1981 and the State-Owned Enterprises Act 1986 which provides that KiwiRail may, from time to time, with the approval of the Minister of Finance, subscribe for or otherwise acquire stocks, debentures, or any interest in any company, body corporate or business.

13. Compensation from The Crown

KiwiRail expects to receive compensation from the Crown as per section 7 of the State-Owned Enterprises Act 1986 for public policy work and projects undertaken by the company which have a public good element or purpose and would not be undertaken on purely commercial grounds.

14. APPENDIX 1: Statement of Current Accounting Policies

1. REPORTING ENTITY

KiwiRail Holdings Limited ("KiwiRail", "the Parent") is a company domiciled in New Zealand, registered under the Companies Act 1993 and is included within the First Schedule of the State Owned Enterprises Act 1986. The Group comprises KiwiRail Holdings Limited and its subsidiaries.

The primary objective of the Group is to establish, maintain and operate, or otherwise arrange for, safe and efficient rail, road and ferry freight and passenger transport services within New Zealand in such a way that revenue exceeds costs, including interest and depreciation; and to provide for a return on capital as specified by the Minister of Finance from time to time.

On 31 December 2012 there was a restructure of the Crown's investment in rail operations. In accordance with the KiwiRail Holdings Vesting Order 2012 which took effect from 31 December 2012, the KiwiRail business was transferred from the New Zealand Railways Corporation ("NZRC") into KiwiRail Holdings Limited. All land previously held by KiwiRail together with the Wellington Railway Station and Social Hall buildings were retained by NZRC.

NATURE OF BUSINESS AND PRINCIPAL ACTIVITIES

The Group carries out the following activities:

- Manage and operate the New Zealand Rail Network
- Provide rail operators with access to the rail network
- Provide advice to the Crown on rail infrastructure issues
- Manage land on the rail corridor
- Operate interisland ferries
- Operate Wellington Metro and long distance rail passenger services
- Operate rail freight transport services in New Zealand
- Carry out engineering and mechanical services to the locomotives and other rolling stock

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice ("NZ GAAP"), and comply with the State-Owned Enterprises Act of 1986, the requirements of the Companies Act 1993 and the Financial Reporting Act 2013. The financial statements have also been prepared on a historical cost basis, except for certain non-financial assets and derivative financial instruments, which have been valued at fair value.

Unless otherwise specified, all dollar amounts in these financial statements and accompanying notes are stated in New Zealand dollars and all values are expressed in millions of dollars ($m). The functional and presentation currency is New Zealand dollars.

(b) Statement of compliance

The financial statements have been prepared in accordance with NZ GAAP. They comply with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") as appropriate for profit-oriented entities and other applicable Financial Reporting Standards.

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

(c) Changes in accounting policies

The accounting policies adopted are consistent with those from financial year 2013 onwards.

(d) Consolidated financial statements

The consolidated financial statements of the Parent and its subsidiaries include the financial statements of subsidiary companies using the acquisition method of consolidation. The acquisition method of consolidation involves recognising at acquisition date, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree.

The Parent values subsidiary companies at the time of acquisition as the identifiable assets and liabilities acquired measured at the aggregate of fair values at the date of acquisition. The difference between the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as a goodwill or a discount on acquisition.

Subsidiary companies are those entities that are controlled directly or indirectly by the Parent.

Unrealised losses relating to impairment of subsidiaries are recognised in the Statement of Financial Performance.

(e) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable by the Parent and Group to the extent it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue represents amounts receivable for goods and services provided in the normal course of business once significant risks and rewards of ownership have been transferred to the buyer.

(i) Freight revenue is recognised based on the date of freight acceptance. Freight revenue also includes maintenance revenue which is recognised at the date that the maintenance service is provided.

(ii) Interislander revenue comprises freight revenue and passenger revenue. Freight revenue is recognised based on the date of freight acceptance. Passenger revenue is recognised at the date of travel.

(iii) Tranz Metro and Tranz Scenic revenue is recognised at the date of travel.

(iv) Property and Corporate revenue comprises rental income, Government funding for operating expenditure and other revenue. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging the operating lease are recognised on a straight-line basis over the lease term.

(v) Infrastructure and Engineering revenue comprises track access revenue, Government funding for operating expenditure, manufacturing revenue, maintenance revenue and other revenue. Track access revenue is recognised on a straight-line basis over the term of the relevant agreement. Manufacturing revenue is recognised by reference to the stage of completion of the contract activity at the balance date, if the outcome of the contract can be reliably estimated. The stage of completion is assessed by reference to surveys of work performed. Manufacturing revenue includes revenue from design services. Maintenance revenue is recognised at the date that the maintenance service is provided.

(vi) Interest income from call and term deposits is recognised as it accrues, using the effective interest method.

(vii) Dividend income is recognised when the right to receive payment has been established.

(viii) Other sources of income are recognised when earned and are reported in the financial periods to which they relate.

(ix) Government funding received as reimbursements of operating costs are recognised as income in the period in which the funding is receivable.

(x) Government funding received as reimbursements of the costs of capital projects is recognised in the same period as the expenditure to which it relates. Where the asset being funded is depreciated over its useful life, the funding is recognised as income on a straight line basis over the same life. Where the asset funded is impaired to residual value the funding is recognised as income in the same period as the impairment expense.

(xi) Grants received in respect of services provided are recognised when the requirements of the relevant grant agreement are met.

(xii) Inter-company sales are eliminated within the Group.

(f) Property, plant and equipment

(i) Recognition and Measurement

Property, plant and equipment asset classes consist of land, buildings, railway infrastructure, rolling stock, ships and plant and equipment.

Property, plant and equipment are shown at cost or valuation, less any accumulated depreciation and accumulated impairment losses. Items of property, plant and equipment in the course of construction are classified as capital work in progress. Cost includes expenditure that is directly attributable to the acquisition of the asset.

Where an asset is acquired for nil or nominal consideration the asset is recognised initially at fair value, where fair value can be reliably determined; and the fair value of the asset received less costs incurred to acquire the asset is also recognised as income in the Statement of Financial Performance.

(ii) Revaluation

Land and buildings are revalued with sufficient regularity to ensure that the carrying amount does not differ materially from fair value. Fair value is determined from market-based evidence by an external, independent valuer. Valuations are undertaken in accordance with the standards issued by the New Zealand Property Institute, NZ IAS 16 *Property, Plant and Equipment* and NZ IFRS 13 *Fair Value Measurement* with the following bases of valuation adopted:

- *Specialised buildings* – valued using optimised depreciated replacement cost.
- *Non-specialised land and buildings* which could be sold with relative ease are valued at market value.

Any revaluation increase arising on the revaluation of land and buildings is credited to the asset revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense in the Statement of Financial Performance, in which case the increase is credited to the Statement of Financial Performance to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of land and buildings is charged as an expense to the Statement of Financial Performance to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

Other additions between revaluations are recorded at cost.

(iii) Derecognition

Realised gains and losses arising from the derecognition of property, plant and equipment are recognised in the Statement of Financial Performance in the period in which the transaction occurs. The gain or loss is calculated as the difference between the carrying amount of the asset and the net disposal proceeds received (if any). Any credit balance attributable to the disposed asset in the asset revaluation reserve is transferred to retained earnings.

(iv) Renewals

Expenditures that are eligible for capitalisation as property, plant and equipment relating to track renewals, ballast formation upgrading, and major overhauls of rolling stock are capitalised at cost as property, plant and equipment. Repairs and maintenance costs are expensed through the Statement of Financial Performance as incurred.

(v) Depreciation

Depreciation is charged on a straight line basis at rates that will allocate the cost or valuation of the asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter. In determining an asset's useful life, consideration is given to its expected usage, its expected wear and tear, technical or commercial obsolescence, and legal or similar limits on its use.

Depreciation is provided on freehold buildings, railway infrastructure, rolling stock, ships and containers, and plant and equipment. Land is not depreciated.

Depreciation on revalued buildings and track assets is charged to the Statement of Financial Performance.

The average depreciable lives for major categories of property, plant and equipment are as follows:

Category	**Useful life**
Infrastructure	
Tunnels & bridges	75 - 200 years
Track & ballast	40 – 50 years
Overhead traction	20 – 80 years
Signals & communications	15 – 50 years
Buildings	35 – 80 years
Rolling stock and ships	
Wagons & carriages	5 - 30 years
Locomotives	5 - 23 years
Ships	20 years
Containers	10 years
Plant and Equipment	
Plant & equipment	5 – 35 years
Motor vehicles	5 – 10 years
Furniture & fittings	5 years
Office equipment	3 – 5 years

(g) Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets are reviewed at each reporting date to determine if there is any indication of impairment. External factors such as changes in expected future processes, technology and economic conditions are also monitored to assess for indicators of impairment. If any such indication exists, the asset or its related cash-generating unit ("CGU") will be tested for impairment by comparing its recoverable amount to its carrying amount. The recoverable amount of an asset or CGU is the higher of its value in use and its fair value less costs to sell.

The value in use for cash-generating assets and CGUs is the present value of expected future cash flows.

If an asset's carrying amount exceeds its recoverable amount the asset is impaired and the carrying amount is written down to the recoverable amount. For revalued assets the impairment is treated as a revaluation decrease (see f(v) above).

For assets not carried at a revalued amount, the total impairment is recognised in the Statement of Financial Performance.

Finance leases on motor vehicles, leasehold improvements and equipment included in plant and equipment asset class are stated at cost less accumulated depreciation and impairment. In the event that settlement of all or part of the purchase consideration is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of the acquisition.

(h) Intangible assets

Intangible assets comprise software applications which have a finite useful life and are recorded at cost less accumulated amortisation and impairment losses.

Intangible assets are recognised initially at cost. Intangible assets with a finite useful life are amortised on a straight-line basis over their estimated useful lives of 3 to 5 years.

(i) Net finance costs

Borrowing costs - are recognised in the Statement of Financial Performance using the effective interest rate method. Where borrowing costs are incurred for the construction of a qualifying asset in accordance with NZ IAS 23 *Borrowing Costs* those costs are capitalised into the cost of the asset.

Other finance costs include interest expense on finance leases and the net change in fair value of derivative financial instruments designated at fair value through profit or loss.

(j) Inventories

Inventories comprise items that are used in the maintenance and operation of the rail network, maintenance of rolling stock and ships, fuel, passenger consumable items, and items used in the manufacture of assets for sale to external parties. Inventories are not held for trading purposes with the exception of consumable cafeteria supplies held on the rail and ferry passenger services.

Inventory is recorded at the lower of cost and net realisable value. Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventory to its present condition and location. Cost is calculated using the weighted average method.

(k) Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement at inception date, whether fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset, even if that right is not explicitly specified in an arrangement.

(i) Group as a lessee

Finance leases

Leases in which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Assets acquired by way of a finance lease are included in property, plant and equipment. They are capitalised at the inception of the lease at the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised in finance costs in the Statement of Financial Performance.

Operating leases

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Operating lease payments are recognised as an operating expense in the Statement of Financial Performance on a straight-line basis over the lease term. Operating lease incentives are recognised as a liability when received and subsequently reduced by allocating lease payments between rental expense and reduction of the liability.

(ii) Group as a lessor

Leases in which the Group retains substantially all the risks and benefits of ownership of the leased asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

(l) Income tax

All members of the group are taxpayers. The accounting policies applied are as follows:

Income tax expense comprises both current and deferred tax. Income tax expense is charged or credited to the Statement of Financial Performance, except when it relates to items charged or credited directly to equity, in which case the tax is charged to equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at reporting date and any adjustments to tax in respect of previous years.

Deferred tax is provided for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the carrying amounts used for taxation purposes.

The amount of deferred tax provided is based on the expected manner of realisation of the asset or settlement of the liability, using tax rates enacted or substantively enacted at each reporting date. Deferred tax assets and liabilities are not discounted.

A deferred tax asset is recognised in the financial statements for all deductible temporary differences and for the carry forward of unused tax losses and unused tax credits only to the extent that it is probable that future taxable surpluses will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Unrecognised deferred tax assets are reassessed at each balance sheet date.

(m) Goods and services tax (GST)

All items in the financial statements are presented exclusive of GST, except for receivables and payables, which are presented on a GST inclusive basis. Where GST is not recoverable as an input tax it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the Inland Revenue ('IR') is included as part of receivables or payables in the Statement of Financial Position.

Cash flows are included in the Statement of Cash Flows on a net basis in respect of GST. The GST components of cash flows arising from investing and financing activities, which are recoverable from or payable to IR, are classified as operating cash flows.

(n) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and the amount can be reliably estimated.

When the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense in relation to any provision is presented in the Statement of Financial Performance net of any reimbursement.

If the effect of the time value of money is material, provisions are determined by discounting the future cash flows. The discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability. Where discounting is used, the increase in the provision for the passage of time is recognised as a finance cost.

(o) ACC Partnership Programme

KiwiRail Holdings Limited and its subsidiary KiwiRail Limited belong to the ACC Partnership Programme whereby each company accepts the management and financial responsibility for employee work-related accidents. Under the programme the employer is liable for all its claims costs for a period of four years up to a specified maximum. At the end of the four-year period a premium is paid to ACC for the value of residual claims, and from that point the liability for on-going claims passes to ACC.

The liability for the ACC Partnership Programme is measured annually by independent actuaries using actuarial techniques at the present value of expected future payments to be made in respect of the employee injuries and claims up to the reporting date. Consideration is given to anticipated future wages and salary levels and experience of employee claims and injuries. Expected future payments are discounted using market yields on secondary market Government bond yields at balance date with terms to maturity that match, as closely as possible, the estimated future cash outflows.

(p) Employee entitlements

Provision is made for benefits accruing to employees in respect of annual leave, retiring leave (including involuntary retirement as medically unfit) and long service leave when it is probable that settlement will be required and they are capable of being measured reliably.

The provision for retiring leave and long-service leave is calculated on an annual basis by independent actuaries.

Provisions made in respect of employee benefits expected to be settled within twelve months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within twelve months are measured on an actuarial basis at the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to the reporting date.

Employee entitlements to salaries and wages, annual leave, long service leave and other similar benefits are actuarially valued on an annual basis and are recognised in the Statement of Financial Performance when they accrue.

(q) Contributions to superannuation plans

Certain employees are members of defined contribution schemes and the Group contributes to those schemes. A defined contribution scheme is a plan under which the employee and the Group pay fixed contributions into a separate entity. The Group has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits in relation to employee service in the current and prior periods. The contributions are recognised as labour and related costs in the Statement of Financial Performance when they are due.

(r) Reimbursement assets

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the Group settles the obligation. The reimbursement is treated as a separate asset.

(s) Interest in a joint arrangement

The Group is party to a joint arrangement with Northland Regional Council. This arrangement is considered as a joint operation under NZ IFRS 11 *Joint Arrangements.* A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. As a party to a joint operation, the Group has recognised the following in relation to its interest in the proposed Oakleigh to Marsden Point rail link:

- Its assets, including its share of any assets held jointly
- Its liabilities, including its share of any liabilities incurred jointly
- Its revenue from the sale of its share of output arising from the joint operation
- Its share of the revenue from the sale of output by the joint operation
- Its expenses, including share of any expenses incurred jointly

(t) Financial assets

Financial assets in the scope of NZ IAS 39 *Financial Instruments: Recognition and Measurement* are categorised as either loans and receivables or at fair value through profit or loss unless designated as a hedged item therefore hedge accounted for. The classification depends on the purpose for which the financial assets were acquired or originated. Designation is re-evaluated at each reporting date, but there are restrictions on classifying to other categories.

When financial assets are recognised initially, they are measured at fair value, plus, in the case of assets not at fair value through profit or loss, directly attributable transaction costs.

Recognition and derecognition
All regular way purchases and sales of financial assets are recognised on the trade date i.e., the date that the Group commits to purchase the asset. Regular way purchases or sale are purchases or sales of financial assets under contracts that require delivery of the assets within the period established generally by regulation or convention in the market place. Financial assets are derecognised when the right to receive cash flows from the financial assets has expired or when the entity transfers substantially all the

risks and rewards of the financial assets. If the Group neither retains nor transfers substantially all of the risks and rewards, it derecognises the asset if it has transferred control of the assets.

Subsequent measurement
(i) Loans and receivables
Loans and receivables comprising cash and cash equivalents and trade receivables are those non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest rate method. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired. These are included in current assets, except for those with maturities greater than 12 months after balance date which are classified as non-current.

- Cash and cash equivalents
  Cash and cash equivalents comprises cash on hand, call deposits and other investments with an initial term of 3 months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

- Trade receivables
  Trade receivables are classified as loans and receivables and are carried at amortised cost using the effective interest method. Trade receivables are not discounted due to their short-term nature.

(ii) Fair value
Financial assets designated at fair value are those derivative financial instruments within predetermined policies and limits in order to manage exposure to fluctuations in foreign exchange, commodity and interest rate risks. The relevant accounting policy for these types of financial assets is set out under 'Derivative financial instruments and hedging activities' in note 2(u)(ii).

Impairment of financial assets

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at each balance date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that have occurred after the initial recognition of the financial asset, the estimated future cash flows of the financial asset has been impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of a doubtful debt provision. When a trade receivable is uncollectible, it is written off against the doubtful debt provision. Subsequent recoveries of amounts previously written off are credited to the Statement of Financial Performance. Changes in the carrying amount of the doubtful debt provision are recognised in the Statement of Financial Performance.

(u) Financial liabilities

Financial liabilities are designated at amortised cost or at fair value through profit or loss unless these are designated as hedged items therefore hedge accounted for.

(i) Amortised cost
Amortised cost is the amount at which the financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount and the maturity amount.

The Group has two types of financial liabilities designated at amortised cost

- *Payables*
  Payables are recognised when the Group becomes obliged to make future payments resulting from the purchase of goods and services. Payables are initially measured at fair value and subsequently measured at amortised cost using the effective interest rate method.

- *Borrowings*
  Borrowings are initially measured at fair value, plus directly attributable transaction costs. Borrowings are subsequently measured at amortised cost using the effective interest method, with the interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period to the net carrying amount of the financial liability.

  Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for more than 12 months after the balance date.

(ii) Fair value

Derivative financial instruments and hedging activities

The Group uses derivative financial instruments within predetermined policies and limits in order to manage its exposure to fluctuations in foreign exchange, commodity and interest rate risks. The Group does not engage in speculative transactions or hold derivative financial instruments for trading purposes.

To manage this exposure the Group uses the following derivative financial instruments:

- Foreign exchange forward contracts and options
- Interest rate swaps
- Fuel commodity hedges

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into (the trade date). Any transaction costs are expensed immediately. The derivative financial instruments are subsequently re-measured to fair value. The method of recognising the resulting gain or loss depends on whether the derivative financial instrument is designated as a hedging instrument, and, the nature of the item being hedged.

Gains and losses, and movements in fair values of derivative financial instruments not in hedging relationships are recognised in the Statement of Financial Performance as follows:

- Foreign exchange forward contracts and options excluding contracts relating to fuel purchases– as part of 'Foreign exchange and commodity net gains and losses'
- Interest rate swaps – as part of 'Net finance costs'
- Fuel related foreign exchange forward contracts and fuel commodity hedges – as part of 'Operating expenses'

The risk management objectives and strategy for undertaking various hedge transactions is covered by the Group Treasury Policy. The Group documents, at the inception of the transaction, the hedging relationship between hedging financial instruments and the hedged items. The Group also documents its assessment, both at hedge inception and on an on-going basis, of whether the derivatives used in the hedging transaction are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of derivative financial instruments is classified as a non-current asset or liability when maturity of the hedged item exceeds 12 months. It is classified as a current asset or liability when the maturity of the hedged item is 12 months or less.

Cash flow hedges

Changes in the fair value of derivative financial instruments designated as cash flow hedges are recognised in the Statement of Comprehensive Income and the cash flow hedge reserve within other comprehensive income to the extent that the hedges are deemed effective. To the extent that the hedges are ineffective for accounting, changes in fair value are recognised in the Statement of Financial Performance in *Foreign exchange and commodity net gains and losses*.

In any of the following circumstances, the Group shall discontinue hedge accounting:

- If a derivative financial instrument expires or is sold, terminated or exercised
- It no longer meets the criteria for hedge accounting
- The forecast transaction is no longer expected to occur
- The designation of the hedge relationship is revoked or changed

In cases where hedge accounting is discontinued as per the circumstance outlined above, the cumulative, unrealised gain or loss recognised in the cash flow hedge reserve in other comprehensive income with respect to the derivative instrument is recognised immediately in the Statement of Financial Performance.

Where the hedge relationship continues throughout its designated term, the amount in the cash flow hedge reserve is transferred to the carrying value of the asset when it is recognised.

(v) Assets held for sale

The Group classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For an asset to be classified as held for sale, it must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable.

An asset held for sale is measured at the lower of its carrying amount and its fair value less cost to sell.

(w) Investment properties

Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met, and excludes the costs of day-to-day servicing of an investment property.

Subsequent to initial recognition, investment properties are measured at fair value, which is based on active market prices, adjusted if necessary, for any difference in the nature, location or condition of the specific asset at the reporting date. Gains or losses from changes in the fair values of investment properties are recognised in the Statement of Financial Performance in the year in which they arise.

Investment properties are derecognised either when they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in profit or loss in the year of retirement or disposal.

(x) Foreign currency translation

Foreign currency transactions are translated to New Zealand currency at the exchange rates ruling at the transaction date.

Monetary assets and liabilities in foreign currencies at balance date are translated at exchange rates ruling at balance date. All exchange differences arising on the translation of monetary assets and liabilities in foreign currencies, whether realised or unrealised, are recognised in the Statement of Financial Performance, except when deferred in equity as qualifying cash flow hedges.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary items in a foreign currency that are measured based on historical costs are translated using the exchange rate at the date of the transaction.

SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES and ASSUMPTIONS

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions of accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

(a) Asset revaluations

The remaining useful lives of property, plant and equipment represents management's best estimates of the useful lives of individual asset classes. When assets are revalued the valuers provide updated expected remaining useful lives for the assets that have been revalued.

Land and buildings are revalued every three years taking into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling to another market participant that would use the asset in its highest and best use.

(b) Impairment of non-financial assets

The Group assesses impairment of all assets at each reporting date by evaluating conditions specific to the Group and to the particular asset that may lead to impairment. These include technological, economic and political factors and future expectations. If an impairment trigger exists the recoverable amount of the assets is determined. If no impairment is stated then management does not consider that the triggers for impairment testing have been significant (see note 19 for further disclosures on impairment of non-financial assets).

(c) Employee entitlements

Independent actuaries are engaged to provide the valuation of employee entitlements. Reliance is placed on the expertise of the independent actuaries to provide accurate valuations of employee benefits. Key assumptions used in calculating this liability include the discount rate and the salary inflation factor. The discount rate is the yield on 10-year Government bonds as at the end of the financial period, which have terms to maturity that match, as closely as possible, to the estimated future cash outflows. The salary inflation factor is determined with consideration of historical salary inflation patterns.

(d) Inventory obsolescence

Management relies on its knowledge of the business to calculate inventory obsolescence provisions. The bulk of inventory held is spare parts for rolling stock and the network. Due to the age of these assets the parts held are many years old and management relies on its knowledge of the business to identify items of inventory that are truly obsolete.

(e) Taxation

The Group's accounting policy for taxation purposes requires management's judgment. Judgement is also required in assessing whether deferred tax assets and liabilities are recognised in some areas. Deferred tax assets, including those arising from unrecouped tax losses, capital losses and temporary differences, are recognised only when they may be recovered, dependent on the generation of sufficient future taxable profits.

The judgement and assumptions are subject to risk and uncertainty; hence there is a possibility that changes in circumstances will alter expectations, which may impact the amount of deferred tax assets and deferred tax liabilities recognised on the Statement of Financial Position and the amount of other tax losses and temporary differences not yet recognised. In such circumstances, some or all of the carrying amounts of recognised deferred tax assets and liabilities may require adjustment, resulting in a corresponding credit or charge to the profit or loss for the year.

(f) Estimation of useful lives of assets

The Group reviews the useful lives and residual values of its property, plant and equipment annually. Assessing the appropriateness of useful life and residual value estimates of property, plant and equipment requires the Group to consider a number of factors such as the physical condition of the asset, expected period of use and expected disposal proceeds from the future sale of the asset. An incorrect estimate of the useful life or residual value will impact the depreciation expense recognised in the profit or loss for the year and the carrying amount of the asset in the Statement of Financial Position.

15. APPENDIX 2: SOE Performance Measure Supporting Definitions

Definitions of SOE Performance Measures

Total Shareholder Return	(Commercial Value$_{end}$ *less* Commercial Value$_{beg}$ *plus* dividends paid *less* equity injected) *divided by* Commercial Value$_{beg}$
Solvency	Current Assets divided by Current Liabilities
Dividend Yield	The cash returned to the shareholder as a proportion of the value of the company.
Dividend Payout	Proportion of net operating cash flows paid out as a dividend to the shareholder after allowance is made for capital maintenance.
Return on Average Equity	NPAT divided by Total Average Equity before Cashflow Hedge Reserve
Return on Average Capital Employed	EBIT divided by Total Average Equity before Revaluation Reserve and Interest bearing liabilities
Operating Margin	Operating surplus after one-off items and gross fair value adjustment divided by Total Revenue
Shareholder's Funds to Total Assets	Total Equity divided by Total Assets
Gearing ratio (net)	Net Debt divided by Total Equity
Interest cover	Operating Surplus before net Fair Value Adjustments divided by Interest Expense on Borrowings

Supporting Financial Definitions

Average Capital	Total equity before revaluations averaged over opening and closing equity for the period
Average Equity	Total equity averaged over opening and closing equity for the period.
EBIT	NPAT before interest, taxation, grant income, derivatives fair value change and gross fair value adjustments.
IFRS Fair Value Adjustment	The value of financial derivatives movement recognised in the Profit and Loss Statement net or gross of taxation.
Net Debt	Face value of borrowings less cash and cash equivalents.
Net Profit after Tax (NPAT)	Reported net profit after taxation
One-off items	Items that because of their nature or incidence should be adjusted in order to assist understanding of the underlying business performance.
Total Assets	Current assets plus non-current assets
Total Equity	Total shareholder's funds including share capital, retained earnings, revaluation and cashflow hedge reserves.

16. APPENDIX 3: Subsidiaries and Associated Companies

The terms share and subsidiary have the same meanings as in section 2 of the State-Owned Enterprises Act 1986.

1. The Company shall ensure at all times that:
   - Control of the affairs of every subsidiary of the Company is exercised by a majority of the Directors of that subsidiary; and
   - A majority of the Directors of every subsidiary of the Company are persons who are also Directors of the Company, Executives of the Company, Executives of a subsidiary of the Company, or who have been approved by the shareholding Ministers for appointment as Directors of the subsidiary.
2. Without consulting shareholding Ministers, neither the Company nor its subsidiaries shall sell or otherwise dispose of, whether by single transaction or any series of transactions, and whether by a sale of assets or shares, the whole or any part of the business, if:
   - That which is to be sold, or disposed of, is valued at more than five percent of the Shareholder's equity in the Company; or
   - The sale or disposal will materially reduce the nature and scope of the business as recorded in Section 3 of the Statement of Corporate Intent

17. APPENDIX 4: Consultation

KiwiRail will consult with its Shareholding Ministers on matters that would have a material effect on the scale, scope, financial return or risk of the activities of the Company or its subsidiaries, including:

(a) Any substantial capital (or equity) investment

(b) The sale or disposal of the whole or any substantial part of the Company or its subsidiaries

(c) Any substantial expansion of activities outside the scope of its business as defined in Section 3 of the Statement of Corporate Intent

(d) Any other significant transactions